No. 12,766

IN THE

United States Court of Appeals

For the Ninth Circuit

JOHN URQUHART BIRNIE, an individual doing business as Birnie Electric Company, and MASSACHUSETTS BONDING AND INSURANCE COMPANY (a corporation),

Appellants,

vs.

THE PERMANENTE METALS CORPORATION (a corporation), and UNITED STATES MARITIME COMMISSION,

Appellees.

BRIEF FOR APPELLEE, THE PERMANENTE METALS CORPORATION.

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Subject Index

Table of Authorities Cited

Cases

Statutes

Miscellaneous

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BRIEF FOR APPELLEE, THE PERMANENTE METALS CORPORATION.

I. JURISDICTION.

Appellant Birnie's statement of the pleadings and facts disclosing the jurisdiction of the District Court and of this Court (App's. Op. Br. pp. 1-2) is correct and is adopted by appellee Permanente.[1]

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[1]We have likewise adopted an abbreviated terminology and will refer to the parties herein as "Permanente", "Birnie", "the Commission", and to Subcontract VS-14 merely as "VS-14".

II. CONCISE STATEMENT OF CASE.

On April 22, 1943, Permanente entered into a prime contract with the Maritime Commission, designated as Contract No. MCc-15762 (R. 595-626) whereby Permanente agreed as prime contractor to construct certain Commission Design VC2-S-AP2 vessels, commonly known as Victory Cargo ships and as AP2s, for the Commission.

On May 29, 1944, Permanente and Birnie entered into a subcontract under said prime contract, approved by the Commission, designated as Vessels Subcontract VS-14 (R. 13-38) whereby Birnie agreed to perform certain work on 22 Design VC2-S-AP5 vessels (a modification of the Victory Cargo ships, commonly known as AP5s) covered by Addendum No. 2 to said prime contract (R. 626-631), such work consisting of installing degaussing, radar, voice tube, mechanical telegraph and mechanical wireways.

VS-14 contained a provision, designated as Special Provision 4, which provided in part as follows (R. 18-20):

> "4. Report of Cost—Excess Profits: The Subcontractor (Birnie) agrees to account for and pay to the Contractor (Permanente) certain profits derived under this contract, and for such purposes agrees:
>
> * * * * * * *
>
> (b) *To pay to the Contractor profit as shall be determined by the Commission in excess of ten (10) per cent of the total contract price which amount shall become the sole property of the Commission.*[2]
>
> * * * * * * *

[2]Emphasis supplied herein unless otherwise indicated.

> It is further understood and agreed that the Commission shall prescribe the method of determining the Subcontractor's profits: * * * the accounting for profits and payments to be made under the provisions of this Article shall be in accordance with the provisions of Section 505 (b) of the Merchant Marine Act, 1936, as amended and the regulations of the Commission issued pursuant thereto * * * *it being understood and agreed that the obligation of the Subcontractor to make payments under this Article is contractual and that such payments shall in effect constitute a reduction of the amount of the contract price which the Contractor is entitled to retain.''*

Birnie undertook the performance of the work under VS-14 and in due course completed the actual work required to be performed by him.

On February 25, 1947, after Birnie had completed the performance of the work under VS-14, the Commission made a determination that the amount of excess profits, or profits in excess of 10% of the contract price, realized by Birnie under VS-14, was $190,490.96, computed as follows:

Stated Contract Price		$430,963.95
Cost of Performance	$197,376.57	
Allowable Profit (10% of $430,963.95)	43,096.40	240,472.99
Recapturable (or Excess) Profits (R. 219-220).		$190,490.96

Before the Commission made its determination of the amount of excess profits to be repaid by Birnie to Permanente, Permanente paid to Birnie for the work performed

by him under VS-14, the sum of $389,419.56, or an overpayment of $148,946.57.

Permanente demanded payment of said $148,946.57 from Birnie, but Birnie refused to pay, claiming that Special Provision 4 of VS-14, relating to the repayment of excess profits, was void and without effect because of the alleged suspension of such profit limitation provisions by Section 401 of Title IV of the Revenue Act of 1940 (34 U.S.C.A. Sec. 496a). Birnie in turn demanded payment from Permanente of $43,185.27, the balance which would be due to him if Special Provision 4 of VS-14 was in fact void and without effect.

Permanente also demanded payment by Birnie of $1,545.66 for goods and services furnished to Birnie by Permanente. Birnie admitted his liability to pay this amount, but refused to pay it claiming it as an offset against Permanente's alleged indebtedness to him.

Permanente also claimed, in the Court below, that by Article 29 of the General Provisions of VS-14 Birnie was required to pay Permanente a reasonable attorney's fee if Permanente prevailed in the litigation.

The Court below held against Birnie's contention that the provisions of Special Provision 4 of VS-14 requiring the repayment of excess profits were ineffective. The Court thereupon concluded that Birnie must pay to Permanente, for the benefit of the Commission and to become the sole property of the Commission, said sum of $148,946.57, less an offset of $34,687.59 which Permanente admittedly owed to Birnie under another sub-contract VS-28, or a net amount of $114,258.98, plus said sum

of $1,545.66, both with interest from the date of demand for payment, plus $15,000.00 as a reasonable attorney's fee. The Court likewise denied Birnie's cross-complaint for $77,872.86, consisting of said $43,185.27 plus said amount of $34,687.59 allowed as an offset.

The only question presented by this appeal is whether or not the Court below was correct in holding that the recapture of excess profits provisions of VS-14 were valid and effective and in rejecting Birnie's contention to the contrary. The only true issue presented is whether VS-14 was a contract to which Section 401 of the Revenue Act of 1940 (34 U.S.C.A. Sec. 496a), an amendment to the Vinson-Trammell Act which suspended the profit limiting provisions of the Vinson-Trammell Act as to certain contracts, was applicable.

Birnie has sought, however, to inject into the case, a false issue as to whether or not the vessels in question were "naval vessels". We have denominated this issue as a false issue because, as we will show herein, the real question is not whether they were naval vessels, but rather whether they were naval vessels *within the meaning of the amendment which suspended the profit limiting provisions of the Vinson-Trammell Act* (34 U.S. Code Sec. 496a), that is, navel vessels *constructed under a contract made by the Secretary of the Navy.* In order to establish that the recapture of excess profits provision of VS-14 is invalid Birnie must establish not only that the vessels in question were naval vessels, *but that they were naval vessels constructed under a contract made by the Secretary of the Navy.* We submit most emphatically that this

cannot be done because it is readily apparent from the subcontract and the prime contract under which these vessels were constructed that they were constructed under a contract with and by the Commission and not under a contract with or by the Secretary of the Navy.

Stated in broad relief and most realistically, the question involved in this case is: Is a subcontractor who entered into a $430,963.95 subcontract for the construction of vessels for the Commission, which subcontract contained a contractual agreement to return all profits in excess of 10% for the benefit of the Commission, to be permitted to retain total profits of $233,587.38, or more than 54% of the contract price, or is he to be limited, as he agreed by contract, to a reasonable profit of 10% of the contract price?

We have stated the issue in its broad aspect to forestall any misconception which the Court might otherwise gain from the opening brief of Birnie to the effect that Birnie is the unfortunate victim of a dastardly scheme on the part of the Commission to deprive Birnie of his legitimate profits or of his right to compute his federal income tax liability to his own best advantage based upon hindsight rather than foresight. All that we seek in this action is to hold Birnie to his contractual obligation which he undertook to assume along with the benefits which he was willing to accept when he entered into his contract with Permanente for the benefit of the Commission.

III. ARGUMENT.

A. SUMMARY OF ARGUMENT.

1. The Court below properly resolved the legal issue in favor of Permanente as a matter of law because:

a. The Excess Profits Provision of VS-14 was a valid and binding contractual provision, predicated upon sound policy and good business practice, and designed to prevent exorbitant wartime profit-making by Commission shipyard subcontractors.

b. Section 496a of Title 34 U. S. Code was not applicable in this case as a matter of law.

(1) The limited effect of Section 496a was to suspend the profit limiting provisions of the Vinson-Trammell Act relating to construction of naval vessels or portions thereof under contract with the Secretary of the Navy.

(2) Section 401 of the Revenue Act of 1940 (Section 496a) does not have the broad effect ascribed to it by Birnie.

(3) Subcontract VS-14 was not a subcontract for the construction of complete naval vessels or portions thereof under the Vinson-Trammell Act.

2. The foregoing points support the judgment as a matter of law. The remaining questions raised by Birnie are entirely immaterial.

a. Section 496a was not made applicable in this case because of the following immaterial matters, claimed by Birnie to render Section 496a applicable.

(1) After construction the vessels were ultimately turned over to the Navy by the Commission and were used by the Navy and were treated in some respects as naval vessels.

(2) The vessels had certain conversion features desired and approved by the Navy and ultimately paid for by the Navy.

(3) The Navy eventually acquired legal title to all but one of the vessels.

b. Section 496a was not made applicable in this case because of the events leading up to the use of the vessels by the Navy, likewise claimed by Birnie to render Section 496a applicable.

c. Even if the vessels had been constructed under the Vinson-Trammell Act, Section 496a would not prohibit the use of the excess profits clause used in VS-14.

3. Birnie's Specification of Error is without merit.

B. ARGUMENT.

1. THE COURT BELOW PROPERLY RESOLVED THE LEGAL ISSUE IN FAVOR OF PERMANENTE AS A MATTER OF LAW BECAUSE:

   a. THE EXCESS PROFITS PROVISION OF VS-14 WAS A VALID AND BINDING CONTRACTUAL PROVISION, PREDICATED UPON SOUND POLICY AND GOOD BUSINESS PRACTICE, AND DESIGNED TO PREVENT EXORBITANT WARTIME PROFIT-MAKING BY COMMISSION SHIPYARD SUBCONTRACTORS.

During the hectic days of wartime ship construction in Commission yards it was not always possible or practical

to determine the approximate cost of subcontract work in advance. Both prime contractors and subcontractors were frequently at a loss to estimate with any degree of accuracy what a particular job might cost under wartime conditions and new and expedited methods of ship construction. Even though subcontracts were usually let upon competitive bidding, there was always the possibility that because of ignorance of actual costs the low bidder might find himself with a profit windfall of exorbitant proportions.

This Court has recognized the necessity under wartime conditions of profit limitation provisions where "because of lack of time for negotiations and the urgency of the times it became impracticable to estimate costs in advance with an exactness which would permit no more than fair profits."

United States v. Bonnell (1950), C.C.A. 9, 180 F. (2d) 145 at 147.

To prevent such excess profits on essential shipyard construction, the Commission recommended the use, by Permanente and other West Coast shipyards working on Commission contracts, of a standard form of Excess Profits Clause in cases where it was difficult to estimate with accuracy the cost of performing a particular subcontract.

In the case of VS-14, because the cost of the work could not be estimated accurately and had not previously been performed by Permanente subcontractors, Permanente included in VS-14, with the knowledge and consent of Birnie, Special Provision 4 for the repayment of excess profits

which Birnie might receive because of uncertainty as to his cost of performance. The intent of the parties as to the effect of the provision is clearly stated in the last paragraph of Special Provision 4 which states "* * * it being understood and agreed that the obligation of the Subcontractor to make payments under this Article is contractual and that such payments shall in effect constitute a reduction of the amount of the contract price which the Contractor is entitled to retain."

The soundness of the policy of the inclusion of such Excess Profits Clause in such contracts is best attested to by the fact that on a contract with a total contract price of $430,963.95, performed in approximately 6 months, Birnie realized profits of $233,587.38, or more than 54% of the contract price.

There can be no question that, in the absence of an express statutory prohibition to the contrary, contracting parties may include in their contract a provision limiting the profits to a certain agreed percentage of the contract price. This is conceded by Birnie as he does not dispute the validity of the contractual provision as such, but claims rather that its inclusion was prohibited by law.

b. SECTION 496a OF TITLE 34 U.S. CODE WAS NOT APPLICABLE IN THIS CASE AS A MATTER OF LAW.

(1) The limited effect of Section 496a was to suspend the profit limiting provisions of the Vinson-Trammell Act relating to construction of naval vessels or portions thereof under contract with the Secretary of the Navy.

The Court's conclusion to this effect is well supported by both common logic and legal precedent.

Section 496a provides as follows:

> "The provisions of section 496 of this title, beginning with the first proviso thereof, * * * shall not apply to contracts or subcontracts for the construction or manufacture of any complete naval vessel or any Army or Navy aircraft, or any portion thereof, which are entered into in any taxable year to which the excess profits tax provided in subchapter E of Chapter 2 of Title 26 is applicable or would be applicable if the contractor or subcontractor, as the case may be, were a corporation, and any agreement to pay into the Treasury profit in excess of 10 per centum, 12 per centum, or 8 per centum, as the case may be, of the contract prices of any such contracts or subcontracts shall be without effect. This section shall also apply to such contracts or subcontracts which were entered into before the date of the beginning of the contractor's or subcontractor's first taxable year which begins in 1940 and which are not completed before such date. Oct. 8, 1940, 11 p.m., E.S.T., c. 757, Title IV, §401, 54 Stat. 1003."

Section 496a appears in Title 34, U.S. Code, relating to "Navy." It suspends the profit limiting provisions of Section 496 of Title 34, U.S. Code, which is Section 3 of the Vinson-Trammell Act (also commonly known and referred to as The Vinson Act) which relates to construction contracted for by the Secretary of the Navy.

Section 496a was originally enacted as Section 401 of Title IV of the Second Revenue Act of 1940. The title of Section 496a as the section appears in its original form at 54 Stat. 1003 is "Suspension of profit limiting provisions of the Vinson Act."

The profit limiting provisions of Section 496 which are suspended by Section 496a relate, in the case of vessels, only to contracts "*made by the Secretary of the Navy* for the construction and/or manufacture of any complete naval vessel * * *, or any portion thereof." Examination of Section 496 shows conclusively that it is limited in effect to such contracts *made by the Secretary of the Navy*. Pertinent portions of Section 496 are as follows:

> "§496. Annual estimates; reports of contractors; limitation on profits
>
> The *Secretary of the Navy* is directed to submit annually to the Bureau of the Budget estimates for the construction of the foregoing vessels and aircraft; and there is authorized to be appropriated such sums as may be necessary to carry into effect the provisions of sections 495 and 496 of this title: *Provided,* That no contract shall be made *by the Secretary of the Navy* for the construction and/or manufacture of any complete naval vessel * * *, or any portion thereof, herein, heretofore, or hereafter authorized unless the contractor agrees—
>
> (a) To make a report, as hereinafter described, under oath, to the *Secretary of the Navy* upon the completion of the contract.
>
> (b) To pay into the Treasury profit, as hereinafter provided shall be determined by the Treasury Department, in excess of 10 per centum of the total contract prices, for the construction and or manufacture of any complete naval vessel or portion thereof, * * * of such contracts *within the scope of this section* as are completed by the particular contracting party within the income taxable year, such amount to become the property of the United States,

* * * *Provided,* That if there is a net loss on all *such* contracts or subcontracts for the construction and or manufacture of any complete naval vessel or portion thereof completed by the particular contractor or subcontractor within any income taxable year, such net loss shall be allowed as a credit in determining the excess profit, if any, for the next succeeding income taxable year, * * *, such net loss or deficiency in profit shall be allowed as a credit in determining the excess profit, if any, during the next succeeding four income taxable years, and that the method of ascertaining the amount of excess profit, initially fixed upon shall be determined on or before June 30, 1939: *Provided further,* That if such amount is not voluntarily paid the Secretary of the Treasury shall collect the same under the usual methods employed under the internal-revenue laws to collect Federal income taxes: *Provided further,* That all provisions of law (including penalties) applicable with respect to the taxes imposed by Title I of the Revenue Act of 1934, and not inconsistent with this section, shall be applicable with respect to the assessment, collection, or payment of excess profits to the Treasury as provided by this section, and to refunds by the Treasury of overpayments of excess profits into the Treasury: *And provided further,* That this section shall not apply to contracts or subcontracts for scientific equipment used for communication, target detection, navigation, and fire control as may be so designated *by the Secretary of the Navy:* * * *

* * * * * * *

(d) That the manufacturing spaces and books of its own plant, affiliates, and subdivisions shall at all times be subject to inspection and audit by any person designated *by the Secretary of the Navy,* the Secre-

tary of the Treasury, and/or by a duly authorized committee of Congress.

(e) * * *

The report shall be in form prescribed *by the Secretary of the Navy* and shall state the total contract price, the cost of performing the contract, the net income, and the per centum such net income bears to the contract price. A copy of such report shall be transmitted to the Secretary of the Treasury for consideration in connection with the Federal income tax returns of the contractor for the taxable year or years concerned.

The method of ascertaining the amount of excess profit to be paid into the Treasury shall be determined *by the Secretary of the Treasury in agreement with the Secretary of the Navy* and made available to the public. * * *''

Section 496 of Title 34 was enacted in 1934 as part of the Vinson-Trammell Act (Act of March 27, 1934; 48 Stat. 503; Sections 494, 495, 496, 497 U.S. Code) dealing with the composition of the Navy. It specifically relates to the construction authorized by Section 495 of Title 34, which, in turn, authorizes the construction of naval vessels to bring the Navy up to treaty strength and confers authority to construct specified vessels for the Navy.

Section 496 is not intended to and does not apply to contracts other than those made with the Secretary of the Navy under the Vinson Act. This has been held by the Circuit Court of Appeals for the Third Circuit in construing the purpose of Section 3 of the Vinson Act (Section 496 of Title 34 U.S. Code). In the case of *Commis-*

sioner of Internal Revenue v. Aluminum Company of America (1944) (C.C.A. 3), 142 Fed. (2d) 663 (Cert. den. 323 U.S. 728, 89 L. Ed. 585), the Court pointed out (142 Fed. (2d) at page 667) that:

> "The aim of the provision (Section 496) was to limit the profits on business done in connection with the naval construction *provided for by the Act.*"

The Court further called attention to the intent of Congress to this effect and said (142 Fed. (2d) at page 667):

> "In the debate in the Senate on the final passage of the bill, Senator Trammell, who had charge of the bill, said that 'the very object and purpose of the principal amendment (relating to profit limitations) which the Senate committee has proposed' is 'to limit the profits on construction *authorized under this bill.*' "

The Court also stated (142 Fed. (2d) at page 668):

> "We think there can be little room for doubt that the purpose of the profit limitation in the Vinson Act was to restrict to ten per cent the profit of anyone furnishing materials or service, worth $10,000 or more, for intended and designated use in naval construction *authorized by the Act.*"

The Court concluded by saying (142 Fed. (2d) at page 668):

> "The evident legislative purpose of the provision can be effectuated fully and uniformly only if the word 'subcontractor', as used therein, is construed to embrace anyone who, by contract or order furnishes specified materials for intended and designated use in identified naval construction *authorized by the Act.*"

The Court also called attention to the fact that there were other profit limiting provisions applicable to the Commission and the Army, as distinguished from the provisions of the Vinson Act which were applicable to the Navy (142 Fed. (2d) at page 669).

A number of other decisions and opinions also established that the Vinson Act is intended to apply only to contracts with the Secretary of the Navy:

In *Waterbury Tool Company v. Commissioner* (1943), 2 T.C. 904, the Tax Court said (2 T.C. at page 907):

> "The petitioner and the Navy Department in 1935 entered into a contract under the 'Vinson Act' of March 27, 1934. That Act in sum provided that contracts entered into *by the Navy Department* * * * should contain provisions by which 'the contractor' should agree, *inter alia,* to make a report upon 'completion of the contract,' to the *Secretary of the Navy,* and to pay into the Treasury profits above 10 per cent of the total contract price; * * *"

In *Erie Forge Co. v. Commissioner* (Dkt. 2283, Dec. 29, 1945, T.C. Memo. Op. 4 C.C.H. T.C. Memo. Dec. page 1127), the Tax Court said (4 C.C.H. T.C. Memo. Dec. at page 1128):

> "Section 3 of the Vinson Act (§496) requires each contractor and subcontractor to pay into the Treasury, all profits in excess of 10 per cent on *Navy Contracts* involving an amount in excess of $10,000."

In *Foster-Wheeler Corp. v. Commissioner* (1940), 42 B.T.A. 36, the Board said (42 B.T.A. at page 39):

> "Section 3(a) of the Vinson Act as originally enacted in 1934 provided, in substance, that in each

Navy contract the contractor must agree to make a report on each contract to the *Secretary of the Navy* upon completion of the contract; * * *"

In *Douglas Aircraft Co. Inc. v. Commissioner* (1942), 46 B.T.A. 1025, the Board said (46 B.T.A. at pages 1030-1032):

"The petitioner in 1935 entered into a contract to construct airplanes for the Navy Department of the United States. At that time the 'Vinson Act' of March 27, 1934, provided in short, that one contracting *with the Secretary of the Navy* must contract to make a report to the Secretary upon the completion of the contract, * * *. After much consideration of this question, we are of the opinion that the parties were not free to define in their agreement 'completion of the contract,' the expression in the Vinson Act. We think that such act does impose the liability for the excess profits. It is true that the form of the act is not altogether clear in this respect, for the provisions as to liability for profit is found in connection with the enumeration of points to which anyone *contracting with the Secretary of the Navy* must agree."

The General Counsel for the Commission has rendered an opinion in line with the principles and authorities discussed above and with particular reference to the issue as presented in this litigation by the contention of Birnie. While we appreciate that such opinion is not binding upon this Court, we believe that it presents a very clear and careful analysis of the effect of Section 496a which will be of interest to the Court as an administrative interpretation of the point in issue and we have therefore

reproduced the opinion in full as Appendix A to this brief.

The Attorney General, in an opinion relating to the Vinson Act, dated April 17, 1934, consisting of a letter to the Secretary of the Navy and appearing at 37 Op. of the Atty. Gen. 487, said in part (37 Op. of the Atty. Gen. at page 488):

> "Responding to your further inquiry concerning your authority, in cases where it may seem to be administratively desirable, to impose such conditions in connection with contracts not covered by the foregoing statute, it is my opinion that this is entirely dependent upon the provisions of other statutes under which the contracts may be made and to be determined without regard to the provisions of the Act of March 27, 1934 (The Vinson Act). In other words, *the latter Act is to be given no effect beyond its terms by analogy or otherwise.*"

See also the opinion of the Comptroller General (B-25432, 21 Comp. Gen. 1103) containing an answer to a letter from the Chairman of the Commission requesting the Comptroller General's comments upon the capital stock tax as an element of cost in contracts containing profit recapture clauses. The Chairman of the Commission in his letter to the Comptroller General indicates clearly that with respect to these profits limitation provisions, it is the Vinson Act which applies to Navy Department contracts and the Merchant Marine Act of 1936 which applies to Commission contracts.

Furthermore, the Regulations promulgated under the Vinson Act by the Treasury Department (see T.D.

4.906, Internal Revenue Bulletins, 1939-2 C.B. 404), are consistent only with the view that the profit limitation provisions of the Vinson Act are limited to contracts of the Secretary of the Navy.

Section 17.1(c) of these Regulations defines the term "contract" to mean an agreement made by authority of the *Secretary of the Navy* for the construction and/or manufacture of any complete naval vessel.

Section 17.1(d) defines the term "contractor" to mean a person entering into a direct contract with the *Secretary of the Navy* or his duly authorized representative.

Section 17.1(e) defines the term "subcontract" to mean an agreement entered into by one person with another person for the construction of a complete naval vessel, the prime contract for such vessel having been entered into by a contractor and the *Secretary of the Navy* or his duly authorized representative.

It appears to us to be incontrovertible in view of the clear wording of Section 496a and Section 496, the Court and other official interpretations cited above, and the Treasury Department Regulations issued under the Vinson Act and quoted from above, that Section 496a has no other or further effect than to suspend the profit limiting provisions of the Vinson Act and that such profit limiting provisions of the Vinson Act relate only to contracts for the construction of complete naval vessels or portions thereof entered into with the Secretary of the Navy. There has been no tendency or inclination of the Courts, Boards or Administrative Agencies to extend the effect of the profit limitation suspension provisions, but on the con-

trary the tendency has been uniformly to strictly limit such effect.

Birnie, however, and in spite of the clear and abundant authority against his position, seeks to induce this Court to set sail upon an unchartered course and to formulate and adopt a novel interpretation and construction of Section 496a never before attributed to it by any Court, Board, or Administrative Agency. Moreover, he seeks to induce the Court to adopt such novel, extreme and unprecedented construction under most inequitable circumstances, since the effect of doing so would be to permit him to retain, at the expense of the Government, exorbitant and unearned wartime profits amounting to almost a quarter of a million dollars and equal to 54% of the contract price.

(2) Section 401 of the Revenue Act of 1940 (Section 496a) does not have the broad effect ascribed to it by Birnie.

Birnie contends (App's. Op. Br. p. 25) that: "The provisions and meaning of Section 401 of the Revenue Act are clear and definite. The plan or scheme for the regulation of excess profits on military and naval construction of all types which is contained in the Revenue Act of 1940 is likewise clear and definite."

As authority for this statement he calls attention to the House Committee Report (H.R. No. 2894, Seventy-sixth Congress, Third Session, August 28, 1940, Int. Rev. Cum. Bull. 1940-2, page 496), and quotes extensively from the Report (App's. Op. Br. pp. 22-24). Such quotations, together with certain other portions from the report which we will refer to herein, show beyond question that

it was only the profit-limiting provisions of the Vinson-Trammell Act which were suspended by Section 401 and not any profit-limiting provisions relating the Commission construction.

Note the following excerpts from the House Committee report:

> "Your committee * * * deems it advisable to stimulate the cooperation of private enterprise in the defense program by suspending the profit limitations *of the Vinson-Trammell Act,* applicable to the construction of naval vessels and Army and Navy aircraft."
>
> "For these reasons your committee recommends * * * the suspension of the profit limitations *under the Vinson-Trammell Act.*"
>
> "*The provisions of the Vinson-Trammell Act,* as amended, relating to limitation of profit on contracts for the construction or manufacture of naval vessels and Army and Navy aircraft, are suspended * * *."
>
> "It is not believed that *the limited types of businesses affected by the Vinson-Trammell Act* should be treated * * * differently from the way in which other businesses engaged in production for the national defense are treated."

Removing any doubt that the committee distinguished between Navy construction and Commission construction is the following excerpt from the same House Committee Report (Int. Rev. Cum. Bull. 1940-2, at page 507):

> "The Merchant Marine Act of 1936, as amended, contains provisions relating to the recapture by the Maritime Commission of profits in excess of 10 per cent of the total contract price of contracts and sub-

contracts for ship construction under that Act. It is not believed desirable to suspend these provisions of the Merchant Marine Act since there are commercial considerations involved which do not apply in the case of the Vinson-Trammell Act. Private ship operators for whom vessels are constructed under the construction differential subsidy and charter provisions of the Merchant Marine Act are vitally interested in the cost of such vessels to the Commission. Furthermore, money recaptured by the Commission under ship construction contracts and subcontracts is paid into the Commission's revolving construction fund where it is available for further ship construction and has the effect of reducing the amounts which otherwise would be required to be appropriated from time to time by the Congress for Maritime Commission shipbuilding."

The Senate Committee Report on the same Bill shows also that the Senate Committee likewise distinguished between Navy construction and Commission construction, as is evidenced by the following excerpt from the Senate Committee Report (S.R. No. 2114, Seventy-sixth Congress, Third Session, September 11, 1940, Int. Rev. Cum. Bull. 1940-2, page 528 at page 544):

"Title IV (Title III of the House Bill). Suspension of Vinson-Trammell Act and Certain Provisions of the Merchant Marine Act, 1936.

"In the House bill this was Title III and contained only one section (301) suspending the profit-limiting provisions *of the Vinson Act* * * *. This section has been renumbered section 401 and has been retained * * *.

"Your committee has also added a new section 402 suspending the profit-limiting provisions *of the Mer-*

chant Marine Act, 1936, as to subcontracts, which would otherwise be subject to such Act, entered into by a *corporate* contractor with a *corporate* subcontractor * * *."

Thus it is apparent that both the House and Senate Committees recognized a distinction between Navy construction and Commission construction.

Section 402 of the Revenue Act of 1940 referred to in the Senate Report was adopted by Congress and is set forth as Appendix B hereto. It differs materially from Section 401 of the Revenue Act of 1940 (Section 496a of Title 34, U.S. Code) in that Section 402 only suspends the profit limiting provisions of Commission construction contracts *where both the contractor and the subcontractor are corporations.* Section 402 would be of no benefit to Birnie in this case since Birnie is not a corporation, but is a sole proprietor, and the suspension of profit limitation provision of Section 402 only applies where both the contractor and subcontractor are corporations. It is apparently because Section 402 fails to cover Birnie's situation as a subcontractor under a Commission construction contract, that he seeks to induce the Court to prostitute the effect of Section 401 to do so. Such prostitution of the effect of Section 401 is directly opposed to the clear intent of the House and Senate Committees and Congress that Section 401 would relate only to Navy construction under the Vinson-Trammell Act.

Moreover, Section 496a specifies that the profit limitation suspension provision shall apply in the case of "any complete naval vessel or any Army or Navy Aircraft".

The fact that Army or Navy Aircraft are specifically mentioned rules out any doubt that the provisions should not extend to types of construction not specifically mentioned, such as Commission vessel construction.

(3) Subcontract VS-14 was not a subcontract for the construction of complete naval vessels or portions thereof under the Vinson-Trammell Act.

The Court's finding and conclusion to this effect were fully supported by the evidence and the law.

Subcontract VS-14 shows upon its face that it was entered into under a Prime Contract between Permanente and the Commission designated as Contract No. MCc-15762 (See Article 43 of Terms and Conditions (R. 35)).

Prime Contract No. MCc-15762 likewise shows upon its face that it was a contract with "The United States Maritime Commission." (R. 595). This is conceded by Appellant (App's. Op. Br. pp. 3-4).

The prime contract itself clearly indicates that a distinction was made between the Commission and the Navy. For example see Article 30 (R. 619-620) which provides that:

> "30(a) The Contractor shall immediately submit a confidential report to the Navy Department with copies to the Commission or such other Government Agencies as said Department may designate * * *
>
> (b) The Contractor shall, whenever directed by the Navy Department *or* the Commission, submit to the Department any and all information * * *
>
> (c) The Contractor shall refuse to employ * * * any person or persons whom the Commission *or* the

Secretary of the Navy or his duly authorized representatives * * * may designate."

The above quoted language of Article 30(c) likewise clearly indicates that the Commission did not act as the agent or representative of the Navy since an express distinction was made between the Commission and the Secretary of the Navy or his duly authorized representatives.

It expressly appears from the face of the prime contract that it was not entered into under the Vinson-Trammell Act. Reference to the first "Whereas Clause" on page 1 of the contract discloses that the Commission's authority for entering into the contract was Public Law 247 and Public Law 630 of the 77th Congress.[3] These laws have no connection with the Vinson-Trammell Act, but were Appropriation Acts whereby the Commission received Appropriations for the construction work and under which the Commission entered into the Prime Contract (see next to last paragraph of Opinion of General Counsel for Maritime Commission, Appendix A hereto).

Public Law 247, 77th Congress (55 Stat. 669, Act of August 25, 1941), is entitled "First Supplemental National Defense Appropriation Act of 1942." It provides in Title III for appropriations to the Commission for the

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[3] "WHEREAS:

1. Under the provisions of Public Law 247 and 630 (77th Congress) the Commission is authorized to construct in the United States, merchant vessels of such type, size and speed as it may determine to be useful for carrying on the commerce of the United States and suitable for the conversion into naval or military auxiliaries and to produce and procure parts, equipment, material and supplies for such vessels, without advertising or competitive bidding;"

exact purposes specified in the first "Whereas Clause" on page 1 of Contract MCc-15762 (see footnote 3).

Public Law 630, 77th Congress (56 Stat. 392, Act of June 27, 1942), is entitled "Independent Offices Appropriation Act of 1942." It provides for appropriations to the Commission to increase the Commission construction fund established by the Merchant Marine Act of 1936 (Act of June 29, 1936, 49 Stat. 1985; 46 U.S. Code Section 1101 et seq.) and provides that such construction fund shall be available for carrying on the activities and functions which the Commission was authorized to perform under Title III of Public Law 247, *supra*.

Public Laws 247 and 630, just discussed, incorporate by reference Section 4 of Public Law 5, 77th Congress (55 Stat. 5, 46 U.S. Code 1119a, b, 1125a), which section provides in part:

> "The Commission is authorized to construct, reconstruct, repair, equip, and outfit, by contract or otherwise, vessels or parts thereof, for any other department or agency of the Government, to the extent that such other department or agency is authorized by law to do so for its own account * * *."

Birnie concedes that the Commission's statutory authority in connection with the vessels contemplated by Prime Contract MCc-15762 is derived from and delimited by Public Law 5 (Apps. Op. Br. p. 30). By such concession he in effect admits that the Commission in constructing the vessels in question operated in accordance with its own functions as a separate instrumentality of the Government, entirely separate and distinct from the Navy Department.

A review of the foregoing statutory authority for the construction work done under Prime Contract MCc-15762 and subcontract VS-14 leads inescapably to the conclusion so aptly expressed by the General Counsel for the Maritime Commission in his Opinion (Appendix A hereto) as follows:

> "It is therefore clear that in constructing vessels which incorporated naval defense features or which were turned over to the Navy, the Commission was not in any sense functioning as an instrumentality of the Secretary of the Navy or the Navy Department, but was pursuing its independent functions as specifically delineated by law.
>
> All of the construction undertaken pursuant to prime contract MCc-15762—which included the hulls upon which work was done under subcontracts VS-14 and VS-28—was strictly within the scope of the program assigned to the Maritime Commission, and quite as clearly not within the scope of the Vinson-Trammell Act."

As demonstrated above, Section 496a only applies to a special category of naval vessels and portions thereof, that is, complete naval vessels and portions thereof constructed under the Vinson-Trammell Act. Therefore, as previously pointed out, appellants attempt to establish that the vessels on which Birnie worked were, or subsequently became, naval vessels, merely injects a false issue into this case. For, even assuming that the vessels in question might or could be shown to come within the dictionary definition of "naval vessels" or the definition of "naval vessels" applied by some court to an entirely different

set of facts, or that the work which Birnie did was on "a portion of a complete naval vessel" under the rationale of a decision or decisions not based on these special facts, this would fall far short of proving that Birnie performed work on naval vessels or portions thereof *constructed under the Vinson-Trammell Act.*

As authority for the proposition that "The work done by Birnie and the equipment installed are clearly a part of a complete vessel within the meaning of the Vinson-Trammell Act," Birnie cites the case of *Pressed Steel Tank Co. v. Commissioner of Internal Revenue* (C.C.A. 7), 133 F.(2d) 776 (App. Op. Br. p. 13). That case is not authority for the above proposition since there the facts involved a contract which was admittedly entered into under the Vinson-Trammell Act for the construction of Navy Destroyers under a contract with the Navy Department, and the only question was whether shells or torpedo heads for such Navy Destroyers were portions of complete naval vessels under the Vinson-Trammell Act. Here, of course, it is contended that the vessels were not constructed under the Vinson-Trammell Act and it would follow therefrom that none of the portions of the vessels were constructed under the Act, even conceding that the work Birnie did was on portions of the vessels.

The other case cited as authority for the same proposition is likewise not authority for the proposition, and for the same reason. The case of *Commissioner of Internal Revenue v. Aluminum Company of America* (C.C.A. 3), 142 F.(2d) 663 (Cert. den. 323 U.S. 728, 89 L.Ed. 585) (Apps. Op. Br. p. 16), also deals with a contract which

was admittedly entered into under the Vinson-Trammell Act with the Navy Department, and where the question was whether or not aluminum supplied for Navy vessels was supplied for the construction of a complete naval vessel under the Act. In fact, this case is the case cited and relied upon by us as the leading authority for the proposition that the application of Section 3 of the Vinson-Trammell Act (Section 496 of Title 34 U.S. Code) is strictly limited to the construction authorized by the Act (see page 15, supra).

Furthermore, the Vinson-Trammell Act profit limiting suspension, when it applies at all, only applies to contracts for "the construction or manufacture of any *complete naval vessel*" (or any Army or Navy Aircraft), "or any portion *thereof* * * *" In other words, before the profit limiting suspension can apply, if otherwise applicable, it must appear that the construction contract relates to a complete naval vessel or a *portion of a complete naval vessel.*

It seems quite evident from the plain wording of the suspension provision that in order to avoid the profit limitation provision of the Act, if the Act were otherwise applicable, it would not be enough to show that the construction related to a naval feature of a vessel which was not a *complete* naval vessel, or, as in this case, to a feature of a basic merchant type vessel. Apparently both the basic vessel itself and the feature added to it must be "naval" in character. To hold otherwise would be to render meaningless the term "*complete* naval vessel" as used in the statute.

The evidence in this case established that the basic vessel upon which Birnie performed his subcontract work was a merchant type vessel:

The prime contract refers in the first "Whereas" clause (R. 595) to the authority of the Commission to construct "merchant vessels" * * * "useful for carrying on the commerce of the United States and suitable for the conversion into naval or military auxiliaries". In the second "Whereas" clause (R. 595) the contract recites that "The Commission has determined that the vessels hereinafter described are of a type, size and speed which will be useful for carrying on the commerce of the United States and suitable for conversion into naval or military auxiliaries." Article 2 (R. 596) refers to the vessels as "steel hulled, steam-propulsive powered, cargo carrying vessels". Reference thereafter in the contract is always to "the vessels", "such vessels", or "said vessels", thus relating back to the basic description of the vessels as merchant or cargo carrying vessels. Addendum No. 2 to the contract again refers in the first "Whereas" clause (R. 626) to the original contract for the construction of "seventy-seven cargo vessels". The second "Whereas" clause of Addendum No. 2 (R. 626) states that the Commission has directed the Contractor "to complete twenty-two of *such* vessels" (hulls 552-573) as "combat loaded troop ships" (Design VC2-S-AP5)". Such reference to the cargo vessels and the statement that twenty-two of *such* vessels (i.e. cargo vessels) are to be completed as "combat loaded troop ships" is clear and convincing proof that these AP5 vessels were considered as basically merchant or cargo carrying vessels.

Out of the 77 hulls covered by the prime contract, 45 of the hulls were delivered by the Commission to private operators for Merchant Marine service and only 32 of the hulls were delivered by the Commission to the Navy (R. 681-683). These were all the same basic merchant, cargo carrying vessel construction with certain modifications superimposed on the basic vessel in the case of the hulls which were delivered by the Commission to the Navy (R. 532).

The vessels in question were basically merchant vessels designed for peace time use in the Merchant Marine, with conversion features suitable to equip them as naval auxiliaries in time of war (R. 527-528). The Commission designation of the VC2-S-AP2 (AP2) vessels meant merely Victory Cargo ship, between 400 and 450 feet long, steam propulsion, type AP2 on the Commission schedule of identifying letters (R. 514-515). The Commission's designation of the VC2-S-AP5 (AP5) vessels referred to in Addendum No. 2 to the prime contract, means merely "Victory Cargo ship, between 400 and 450 feet long, steam turbine design, AP 5th modification" (R. 520-521). The designation "AP" in the Commission's designation had no connection with the Navy designation APA, and the similarity in the letters "AP" was occasioned by a peculiar coincidence rather than by intent (R. 514-519, 532-534).

The design for the AP5s was a Commission design (R. 522-527).

The conversion features in the AP5s, which were not in the AP2s, were kept to a minimum so as not to destroy

the value of the vessels for rehabilitation to cargo vessels when the Navy had finished with their use (R. 526). The conversion features were minor and did not affect the basic design (R. 526-527), and many of the vessels have since been restored to merchant cargo vessels (R. 527).

The construction standards for strict Navy construction by the Navy Department were more stringent than the standards prescribed by the Commission and the American Bureau of Shipping for merchant vessels such as the AP2s and AP5s. Such strict Navy construction standards were not followed in the construction of the AP2s and AP5s (R. 571-576, 563-569).

The work that Birnie did on the AP5s substantially all had its counterpart in the AP2 Victory Cargo vessels and was not work of a character which was limited to naval vessels, but on the contrary was commonly found on merchant cargo vessels during wartime. VS-14 called for work by Birnie on degaussing, radar, voice tube, mechanical telegraph, and mechanical wireways. These various items, with the single exception of radar, also had to be installed in substantially the same form on the AP2 cargo vessels (R. 529-532).

Thus the evidence showed that the AP5s were not "complete naval vessels", but were basically merchant cargo vessels with certain modifications commonly found in one form or another on wartime cargo carrying vessels, and that the so-called "naval features" of the AP5s were not exclusively naval in character, but were common to most, if not all, wartime cargo carrying vessels. Therefore, even if the profit limiting provisions of the Vinson-Trammell

Act might otherwise have applied, the evidence showed that the work done by Birnie was not on "complete naval vessels" or "portions of complete naval vessels".

2. THE FOREGOING POINTS SUPPORT THE JUDGMENT AS A MATTER OF LAW. THE REMAINING QUESTIONS RAISED BY BIRNIE ARE ENTIRELY IMMATERIAL.

We contended at the trial of this action, and reaffirm the contention here, that the Court should hold, as a matter of law, based upon the foregoing considerations, that Section 496a was not applicable in this case and that therefore the remaining points raised by Birnie are entirely immaterial. At the trial we entered an objection to all evidence which related to these immaterial matters, that is, to what happened to the vessels after they were delivered to the Commission by Permanente, to what the Navy did with relation to the vessels after it received them from the Commission, and to what was done by the Navy and the Commission before or during the construction of the vessels (R. 254, 255, 262, 263). The Trial Court admitted such evidence under a ruling which leaves some doubt as to whether the Trial Court's decision was based solely upon the legal issue discussed above or whether the Trial Court also considered the evidence on the matters claimed by us to be immaterial and decided the case on the factual as well as the legal issue (R. 263).[4]

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[4]"The Court. Well, I am prepared to make my ruling upon these objections that I sense are going to be made by you as the evidence progresses. As I understand it, the crux of the controversy between Permanente and Birnie is whether or not they are naval vessels. I think it is expeditious to receive this evidence, and should I finally decide the case in accordance with Permanente's theory, the implication necessarily would be that I have given no consideration to this evidence to which objection has

We proceed now to a discussion of said immaterial matters raised by Birnie in his brief.

a. **Section 496a was not made applicable in this case because of the following immaterial matters, claimed by Birnie to render Section 496a applicable:**

(1) **After construction the vessels were ultimately turned over to the Navy by the Commission and were used by the Navy and were treated in some respects as naval vessels.**

Birnie stresses in his Opening Brief (Ap. Op. Br. pp. 15-16) that the vessels in question were delivered by the Commission to the Navy, accepted by the Navy, officially commissioned as ships of the Navy, given Navy designations as APA's, given Navy names and numbers, and used by the Navy.

However, since Section 496a only applies to naval vessels constructed under the Vinson-Trammell Act, the question of the use to which vessels not constructed under the Act are subsequently put and the details connected with such use is entirely immaterial. Thus the question of the use to which the vessels were put after Permanente delivered them to the Commission, and whether or not any Navy attributes later attached, turns out to be merely another facet of the false issue mentioned above, and for the same reason.

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been made. In that event, of course, no injury would result to the plaintiff from the ruling.

However, there would be a saving of time in resolving the issues in favor of the party who finally prevails, because if I decide in favor of the plaintiff's theory and the reviewing court decrees the judgment should follow the theory for which the defendant contends, the record would be complete. So, for those reasons I am going to overrule the objection you just made and the objections which I sense you intend to make, and receive the evidence. The objection is overruled."

For purposes of illustration, take the case of a private yacht constructed at the cost of its private owner in a commercial shipyard. Assume that the Navy requisitioned this private yacht for war duty, and used the yacht with a Navy crew for purposes of submarine detection or other naval duty, as we understand was actually done in some cases. Assume further that such vessel was commissioned by the Navy, given a Navy designation, number and name, and used by the Navy. While it would be difficult to deny that such yacht, so used, would be used as a "naval vessel," it would be equally difficult to establish that such yacht was a "naval vessel" *constructed under the Vinson-Trammell Act.*

So here, naval use alone, with all of the attendant features mentioned by Birnie, will not convert vessels constructed by the Commission under Public Laws 247 and 630 of the 77th Congress, into naval vessels *constructed by the Secretary of the Navy under the Vinson-Trammell Act.*

Any action on the part of the Navy with relation to these vessels could not in any manner affect the contractual relations between Permanente and Birnie or Permanente and the Commission and could not be binding in any manner upon Permanente, who had no direct contractual relations with the Navy with respect to such vessels. Obviously Permanente had no control over what the Commission might do with such vessels after Permanente completed its contractual obligations with the Commission and delivered the vessels to the Commission, nor did Permanente have any control over what the Navy

might do with such vessels after it acquired them from the Commission, or over what the Navy might show on its records concerning these vessels. These matters were entirely immaterial.

(2) The vessels had certain conversion features desired and approved by the Navy and ultimately paid for by the Navy.

Birnie likewise stresses in his opening brief (App.'s Op. Br. p. 15) the fact that although the vessels were derived from standard Commission hulls and propulsion machinery, they were converted structurally and especially equipped to the extent necessary for naval use and that the Navy ultimately paid the Commission the cost of such conversion features.

Here again is presented another facet of the previously exposed false issue. For just as the use to which the vessels are put will not convert them into naval vessels *constructed under the Vinson-Trammell Act,* neither will the fact that they contain features requested and approved by the Navy and paid for by the Navy convert them into vessels *constructed under contract with the Secretary of the Navy under the Vinson-Trammell Act.*

Under VS-14 Birnie is obligated to Permanente and not to the Navy. Under the prime contract Permanente is obligated to the Commission and not to the Navy. Birnie was required to perform his obligations under VS-14 to the satisfaction primarily of Permanente and secondarily of the Commission. He had absolutely no contractual obligation to the Navy. Under these circumstances a contract requirement for approval by the Navy of certain

features of the work could not render the work in question naval construction, much less naval construction under the Vinson-Trammell Act.

Actually, as pointed out in the Opinion of the General Counsel for the Commission (Appendix A hereto), Naval approval was required as a matter of law of all vessels which were to be operated by the Navy. The Merchant Marine Act of 1936 (46 U.S. Code, Sections 1101 et seq.; 49 Stat. 1985), by which the Commission was created, recites in its Declaration of Policy (Title I) the purpose of developing a merchant marine "capable of serving as a naval and military auxiliary in time of war or national emergency * * *." Compliance with this policy would require that defense features incorporated in merchant vessels constructed in wartime and presumably for use in the war should be subject to naval inspection and approval. Such approval was also required by Public Law 76, 78th Congress (34 U.S. Code, Section 498d-2; 57 Stat. 156) approved June 17, 1943, which provides in part:

> "Notwithstanding the provisions of any other law any vessel intended for operation by the United States Navy, the construction or acquisition and conversion of which was hertofore or is hereafter authorized for the Maritime Commission, the War Shipping Administration, or any other agency of the Government, shall be subject to the approval of the Navy Department in all matters of design and construction or conversion, and the control, custody, and sole right to possession of such vessel shall be transferred to the Navy Department upon the completion of such construction or conversion * * *."

Even though these vessels did contain certain conversion features, they were basically Commission merchant type vessels (see discussion of evidence at pages 30-33 supra).

While it is true that the Navy paid the Commission $34,213,000 for the conversion features only, the total cost of $89,500,000 was originally paid by the Commission to Permanente (R. 435, 469). Thus the entire cost was paid initially by the Commission and the largest share of the cost was paid ultimately by the Commission.

(3) The Navy eventually acquired legal title to all but one of the vessels.

Birnie also stresses in his Opening Brief (App's. Op. Br. p. 16) that legal title to all but one of the vessels under VS-14 was transferred by the Commission to the Navy on or about January 14, 1946.

The transfer of title to certain of the vessels to the Navy in 1946, almost three years after the prime contract was executed and almost two years after VS-14 was executed, is entirely immaterial in this case and is no evidence whatsoever that the vessels were constructed under the Vinson-Trammell Act.

Even if the question of transfer of title were material, however, the evidence established that the transfer of title was entirely uncontemplated by the Commission and the Navy at the time Birnie entered into VS-14 and was worked out almost three years subsequently as a matter of bargaining between the Commission and the Navy and as a part of the overall program of post-war disposition of vessels.

The original arrangement between the Commission and the Navy was that the Commission would retain title to the vessels but would make them available to the Navy for the duration of the emergency on a loan-charter basis (R. 735-741). After the war and as late as December 27, 1945, the Navy Department requested for the first time that the Commission transfer title to certain Commission constructed vessels to the Navy (R. 746-748). Thereafter, and as the result of an agreement between the Commission and the Navy Department involving title to a number of other vessels as well, the Commission agreed to transfer all but one of the vessels under VS-14 to the Navy in return for certain concessions by the Navy as to other vessels which the Commission desired from the Navy (R. 749-750).

This evidence showed that at any time Birnie had any connection with the vessels under VS-14 they were Commission owned and the Navy's subsequent acquisition of title to all but one of them was at the sufferance of the Commission. Such evidence furnished further proof that such vessels were not constructed under the Vinson-Trammell Act, in which event title to the vessels would have been in the Navy at all times.

b. Section 396a was not made applicable in this case because of the events leading up to the use of the vessels by the Navy, likewise claimed by Birnie to render Section 496a applicable.

Birnie contends (App's. Op. Br. p. 17) that "Quite aside from the events leading up to their actual use by the Navy and their physical characteristics, undisputed evidence showed that these vessels were constructed by the Commission for the intended ultimate use of the

Navy pursuant to letter arrangement between the two agencies and because of this ultimate use by the Navy, they are naval vessels as a matter of law."

In support of this novel and unprecedented theory Birnie cites the "land-grant rate cases" (*Southern Pacific Co. v. Defense Supplies Corp.* (D.C. Cal.) 64 F. Supp. 605, and *Northern Pacific Railway Company v. United States of America,* 330 U.S. 248, 91 L.Ed. 876) as authority for the proposition that the vessels in question were naval vessels as a matter of law. These cases, while adopting a broad view of what constitutes military or naval use and thus giving the government the benefit of the reduced land-grant freight rates on a broad category of freight shipped in war time, certainly do not establish what Birnie must establish in this case, that is, that contracts for the construction of vessels, when made by the Commission, are contracts of the Secretary of the Navy. The land-grant rate cases are concerned only with the effect of the "land-grant allowance" legislation, and not the Vinson-Trammell Act.

This contention is merely another manifestation of the previously exposed false issue, since to prevail in this litigation Birnie must establish not only that the vessels are naval vessels but that they are naval vessels *constructed under the Vinson-Trammell Act.*

As indicated above, we contended at the trial of this action that the chain of correspondence referred to by Birnie in support of this unique claim is entirely irrelevant and immaterial to the simple legal issue here presented, and that the Court should decide, without any

reference to such correspondence, that as a matter of law the vessels were not constructed under the Vinson-Trammell Act (supra, p. 33).

Even if evidence of this nature is considered as material, however, it is further proof that the contract for the construction of these vessels was not with the Secretary of the Navy under the Vinson-Trammell Act. Such correspondence further shows conclusively that the vessels construction program was not initiated by the Secretary of the Navy, but rather by the Commission at the request of *The Joint Chiefs of Staff*. It also establishes without question that the vessels were at all times considered as Commission vessels and that they were merely loaned by the Commission to the Navy under an agreement whereby the Commission would retain title to the vessels and they would be returned to the Commission as soon as practical after the termination of the emergency.

As shown by the letter of November 9, 1943 from Admiral William D. Leahy, USN, as Chief of Staff to the Commander in Chief of the Army and Navy, *acting for the Joint Chiefs of Staff*, to Rear Admiral E. S. Land, Chairman of the Commission (R. 724-725), the request for the conversion of these Victory Cargo Ships came not from the Secretary of the Navy, but *from the Joint Chiefs of Staff*. This was the origin of the conversion program, the request *from the Joint Chiefs of Staff*, and any subsequent dealings between the Commission and the Navy Department were merely to give effect to the request *of the Joint Chiefs of Staff*, not the Secretary of the Navy.

In reply to said letter of November 9, 1943, on December 6, 1943 Admiral E. S. Land, Chairman of the Commission, wrote to the Secretary of the Navy and referred to the request *of the Joint Chiefs of Staff* for the Commission to construct such vessels and confirmed the fact that the conversion of AP2S and AP3S would be in accordance with contract plans and specifications to be furnished by the Commission and working plans to be prepared by George Sharp, Naval Architect (R. 726-727).

In a letter dated December 10, 1943 from the Bureau of Ships to the Chairman of the Commission, referring further to the letter of December 6, 1943, reference is made to the fact that the ships were to be built on Victory Ship hulls, the contract plans and specifications were to be furnished by the Commission and the working plans were to be prepared by George Sharp, Naval Architect (R. 730-732).

On February 29, 1944 the Secretary of the Navy in a letter to the Chairman of the Commission confirmed the arrangement mentioned above whereby the Navy agreed to accept the vessels on a loan-charter basis from the Commission for the duration of the emergency, whereby the Commission agreed to transfer the control, custody and sole right of possession of the vessels to the Navy, and the Navy agreed to return the vessels to the Commission as soon after the termination of the emergency as circumstances and conditions would permit without further act or deed (R. 735-741).

On April 14, 1944, General G. C. Marshall, *for the Joint Chiefs of Staff,* in a letter to the Chairman of the

Commission again referred to the original letter of November 6 (November 9), 1943 *from the Joint Chiefs of Staff* whereby *the Joint Chiefs of Staff* requested the Commission to construct the 130 APA's, and modified the earlier letter by diverting 6 of the hulls for conversion by the Navy to hospital ships. This letter is further evidence that *the Joint Chiefs of Staff,* rather than Secretary of the Navy, initiated and controlled the conversion program (R. 689-690).

On April 25, 1944 the Chairman of the Commission, by letter, called the attention of the Secretary of the Navy to the requirements of Public Law 204, 77th Congress (57 Stat. 604), approved December 17, 1943, which provided in part:

> "* * * no sums expended by the Maritime Commission from funds appropriated to it for the construction of vessels which are transferred to the Navy shall be reimbursed from naval appropriations, except to the extent of agreements existing on the effective date of this Act; Provided, further, that vessels acquired by the Navy from the Maritime Commission without reimbursement shall not be disposed of except by return to the Maritime Commission."

and requested the Navy to confirm its agreement to an arrangement worked out between the Commission, the War Shipping Administration and the Navy, which would effectuate the policy of Public Law 204 (Pltfs.' Ex. HH, Ex. P to Deposition of R. L. McDonald).[5]

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[5]This exhibit was omitted from the Transcript of Record by stipulation with the understanding that it could nevertheless be considered as an exhibit. See Stipulation Shortening Contents of Printed Book of Exhibits (R. 587).

Attached to the letter was a Memorandum of Agreement dated 9 March 1944 which sets forth under 2. the arrangements as to "Merchant vessels constructed by the Maritime Commisison with its funds for operation by War Shipping Administration and delivered to the Navy by the Maritime Commission or War Shipping Administration (for manning and operation)." This arrangement, applicable to the vessels in question, specified that the Commission would not be reimbursed for its construction costs but would be reimbursed by the Navy for the cost of conversion work and delivery costs and for special materials and equipment furnished by the Navy, and further that the vessels would be delivered by the Commission to the Navy on a loan-charter basis and without transfer of title.

On May 25, 1944 the Secretary of the Navy by letter to the Chairman of the Commission agreed to the terms of the Memorandum of Agreement dated 9 March 1944 enclosed in the letter of 25 April 1944 (R. 691).

On June 3, 1944 the Chairman of the Commission wrote to the Secretary of the Navy and again referred to the previous request of the *Joint Chiefs of Staff* and requested the Navy to agree to reimburse the Commission for any and all expenses incurred in any manner in connection with the delivery and conversion features of the vessels at the request of the Navy. He required Navy approval of this request as an additional condition for the transfer of the vessels (R. 742-744).

On July 3, 1944 the Secretary of the Navy wrote to the Chairman of the Commission and agreed to such addi-

tional condition for the transfer of the vessels (R. 744-745).

In the foregoing documents is convincing proof that *the Joint Chiefs of Staff,* not the Secretary of the Navy, initiated the conversion program; that the Commission, not the Secretary of the Navy, constructed the vessels; that the Commission, not the Navy Department, was originally scheduled to retain title to the vessels; that the Commission transferred possession of the vessels to the Navy Department on a loan-charter basis only and subject to the obligation of the Navy Department to return the vessels to the Commission; and that the Commission was reimbursed by the Navy Department for certain features only under Public Law 204, 77th Congress, and not under or by virtue of the Vinson-Trammell Act.

c. Even if the vessels had been constructed under the Vinson-Trammell Act, Section 496a would not prohibit the use of the excess profits clause used in VS-14.

Section 496a suspends the profit limitation provisions of Section 496, that is profit limitations which require an agreement to pay *into the Treasury excess profit as determined by the Treasury Department* under specified contracts performed during the income tax year, and provided that if the excess profits are not voluntarily paid into the Treasury the Secretary of the Treasury shall collect them under the usual methods employed under the internal-revenue laws to collect Federal income taxes.

Special Provision 4 of VS-14 would not violate the requirement of Section 496a even if the vessels in ques-

tion had been constructed under the Vinson-Trammell Act. Special Provision 4 does not require any payment *into the Treasury* as required by Section 496, nor does it provide for the determination of excess profits *by the Treasury Department,* nor does it provide for collection of unpaid excess profits by the Secretary of the Treasury under the usual methods employed under the internal revenue laws to collect Federal income taxes. If that type of provision were involved in this case there would obviously be no necessity for an action of this kind, as the Secretary of the Treasury would merely collect the excess profits as he would collect unpaid income tax.

Special Provision 4 provides, on the contrary, for the payment of excess profits under a single specified contract, as determined by the Commission, to a private contractor, Permanente, for the benefit of the Commission, and without collection of such excess profits in the same manner as Federal income taxes are collected. It is true, as stipulated by Permanente and the Commission that Permanente will pay to the Commission the excess profits recovered in this action as a matter of contract between Permanente and the Commission. Such payment to the Commission, however, is not in any sense a payment into the Treasury but rather would go to the Commission to be used in the performance of its functions as delineated by law. (See to this effect excerpt from House Committee Report (H.R. No. 2894, Seventy-sixth Congress, Third Session, August 28, 1940, Int. Rev. Cum. Bull., 1940-2 at page 507, set forth supra at pages 21-22).)

Moreover, Section 496 sets up as a matter of *statute* a particular kind of profit limitation provision which was required by law to be incorporated in every contract of

the Secretary of the Navy under the Vinson-Trammell Act. Special Provision 4 of VS-14 is not that kind of profit limitation provision, but is *contractual* rather than statutory and the last clause of Special Provision 4 so states as follows:

> ". . . it being understood and agreed that the obligation of the Subcontractor to make payments under this Article is contractual and that such payments shall in effect constitute a reduction of the amount of the contract price which the Contractor is entitled to retain."

3. BIRNIE'S SPECIFICATION OF ERRORS IS WITHOUT MERIT.

Birnie specified 5 alleged errors in the Trial Court's Findings of Fact (App. Op. Br. pp. 6-7).

As to Specifications 1 and 2, as indicated above (p. 33, f.n.4) there is doubt as to whether the Trial Court considered the factual matters involved in a determination of whether VS-14 was a contract for the construction of complete naval vessels or portions thereof. However, there is abundant evidence in the record and discussed above to support these findings. (See pp. 24-33 hereof.)

As to Specifications 3 and 5, these findings to the effect that it was the Commission and not the Secretary of the Navy who made the contracts, are abundantly supported by the evidence. (See pp. 24-27 hereof.)

As to Specification 4, the finding that Permanente performed all acts and things required on its part to be done and performed under VS-14, Birnie stipulated that Permanente had so performed except for the payment of the money claimed to be due to Birnie from Permanente (R. 190).

The remaining Specifications of Error all relate to the Trial Court's Conclusions of Law. These specifications thus involve only the legal issues discussed above and which the Trial Court properly resolved in favor of Birnie.

CONCLUSION.

Birnie, unsatisfied with a legitimate and reasonable profit, seeks to have this Court depart from sound legal precedent and common logic in order to reach a most inequitable result—a result which would release him retroactively and unfairly from his binding and legal contractual commitment to return excess profits in excess of 10% of the contract price. The Trial Court quite properly rejected this unsound and inequitable effort. We respectfully submit that, in view of the reasons set forth above, this Court should do likewise and should affirm the judgment of the District Court against appellant Birnie.

Dated, San Francisco, California,
June 20, 1951.

Respectfully submitted,
BRUCE WALKUP,
WILLIS S. SLUSSER,
THELEN, MARRIN, JOHNSON & BRIDGES,
Attorneys for Appellee,
The Permanente Metals Corporation.

(Appendices A and B Follow.)

Appendices A and B.

Appendix A

UNITED STATES MARITIME COMMISSION
Washington

January 31, 1947

Thelen, Marrin, Johnson & Bridges, Esqs.
111 Sutter Street
San Francisco 4, California

Attention: Mr. Bruce Walkup

Dear Sirs:

The Permanente Metals Corporation—Richmond Shipyard Number Two vs. Birnie Electric Company

I have your letter of January 21, 1947, requesting my opinion as to the validity of the profit limitation provisions in subcontracts Nos. VS-14 and VS-28 between Permanente Metals Corporation and Birnie Electric Company. Both subcontracts were awarded under prime contract MCc-15762 between Permanente Metals Corporation and the Maritime Commission.

The profit limitation provisions were identical in both subcontracts and, insofar as material to your question, provided:

"Special Provisions:

IV. *Report of Cost—Excess Profits:*

The subcontractor agrees to account for and pay to the contractor certain profits derived under this contract, and for such purposes agrees:

* * * * * * * *

(b) To pay to the contractor profit as shall be determined by the Commission in excess of ten (10) per cent of the total contract price which

amount shall become the sole property of the Commission."

Your letter states that the subcontractor asserts that the foregoing provision is invalid under the amendment to the Vinson-Trammell Act (34 U.S. Code Sec. 496a; 54 Stat. 1003) which provides:

"Sec. 496a. *Same; suspension of profit limiting provisions*

"The provisions of section 496 of this title, as amended, beginning with the first proviso thereof, and section 2(b) of the Act of June 28, 1940 (c. 440, 54 Stat. 676, Public, Numbered 671, Seventy-sixth Congress, third session), shall not apply to contracts or subcontracts for the construction or manufacture of any complete naval vessel or any Army or Navy aircraft, or any portion thereof, which are entered into in any taxable year to which the excess profits tax provided in subchapter E of Chapter 2 of the Internal Revenue Code is applicable or would be applicable if the contractor or subcontractor, as the case may be, were a corporation, and any agreement to pay into the Treasury profit in excess of 10 per centum, 12 per centum, or 8 per centum, as the case may be, of the contract prices of any such contracts or subcontracts shall be without effect. This section shall also apply to such contracts or subcontracts which were entered into before the date of the beginning of the contractor's or subcontractor's first taxable year which begins in 1940 and which are not completed before such date."

In my opinion, this statute has no bearing upon the profit limitation provisions of subcontracts VS-14 and VS-28. I regard those provisions as wholly valid.

Section 496a of Title 34 of the U. S. Code must be read in its proper context. It constitutes an amendment of the Act of March 27, 1934 (48 Stat. 503) which related to the composition of the Navy, and adopted for the first time the statutory principle that profits derived from naval construction under the act should be regulated by law.

The profit limitation provision of the Vinson-Trammell Act is Section 496 of Title 34 of the U.S. Code, which provides in part:

> "Sec. 496. *Annual estimates; reports of contractors; limitation on profits*
>
> "The Secretary of the Navy is directed to submit annually to the Bureau of the Budget estimates for the construction of the foregoing vessels and aircraft; and there is authorized to be appropriated such sums as may be necessary to carry into effect the provisions of sections 495 and 496 of this title: Provided, That no contract shall be made *by the Secretary of the Navy* for the construction and/or manufacture of any complete naval vessel or aircraft, or any portion thereof, herein, heretofore, or hereafter authorized unless the contractor agrees—
>
> * * * * * * * *
>
> "(b) To pay into the Treasury profit, as hereinafter provided shall be determined by the Treasury Department, in excess of 10 per centum of the total contract prices, for the construction and or manufacture of any complete naval vessel or portion thereof * * *."

The words which I have italicized in the foregoing quotation indicate that the profit limitation provisions of

Section 496 relate solely to contracts made by the Secretary of the Navy. Section 496a, suspending the profit limitation provisions of Section 496, constitutes, by its own terms, a limitation of the scope of Section 496. It has no other or further effect. Since Section 496 establishes a rule of profit limitation as to contracts made by the Secretary of the Navy, and since Section 496a suspends those profit limitations, the suspension effected by Section 496a is operative only with respect to contracts made by the Secretary of the Navy. Consequently, Section 496a is in no way applicable to the contracts of the Maritime Commission, or to subcontracts thereunder.

If any support other than the plain language of the statute is needed to support this conclusion, it is found in the title of Section 496a as the section appears in its original form at 54 Stat. 1003. It was enacted as Section 401 of Title IV of the Second Revenue Act of 1940. The caption of Section 401 is "*Suspension of profit limiting provisions of the Vinson Act.*" From this language it is apparent that no profit limitation provisions other than those of the Vinson Act were suspended by Section 401.

My conclusion as to the validity of the disputed provisions in the subcontracts is not affected by the circumstance that other provisions in the agreements required specified items of work to be approved by the United States Navy. Such requirements as these fall far short of transforming a Maritime Commission contract into a Navy contract. The Merchant Marine Act, 1936 (46 U.S.C. Sections 1101, et seq.) recites in its declaration of policy the purpose, among others, of developing a merchant marine "capable of serving as a naval and

military auxiliary in time of war or national emergency * * *." Compliance with this policy obviously requires that defense features incorporated in merchant vessels constructed in wartime and presumably for use in the war should be subject to naval inspection and approval. The provisions for Navy approval, however, were required not merely as a matter of policy prescribed by the Merchant Marine Act, 1936, but as a matter of specific statutory duty, in consequence of Public Law 76, 78th Congress (34 U.S.C. Sec. 498d-2; 57 Stat. 156), approved June 17, 1943, which provides in part:

> "Notwithstanding the provisions of any other law any vessel intended for operation by the United States Navy, the construction or acquisition and conversion of which was heretofore or is hereafter authorized for the Maritime Commission, the War Shipping Administration, or any other agency of the Government, shall be subject to the approval of the Navy Department in all matters of design and construction or conversion, and the control, custody, and sole right to possession of such vessel shall be transferred to the Navy Department upon the completion of such construction or conversion * * *."

This provision applies to work done under subcontracts VS-14 and VS-28 since both were executed after the effective date of the enactment.

Prior to the enactment of Public Law 76, 78th Congress, the Commission had been authorized by Public Law 5, 77th Congress (55 Stat. 5) to perform work for other Government agencies and departments. Section 4 of that act provided in part:

> "The Commission is authorized to construct, reconstruct, repair, equip, and outfit, by contract or otherwise, vessels or parts thereof, for any other department or agency of the Government, to the extent that such other department or agency is authorized by law to do so for its own account * * *."

This provision was incorporated by reference in Public Law 247, 77th Congress (55 Stat. 669, 681—"First Supplemental National Defense Appropriation Act, 1942") and Public Law 630, 77th Congress (56 Stat. 392—Independent Offices Appropriation Act, 1943") which were the appropriation acts under which the Commission entered into Contract MCc-15762, this being the prime contract pursuant to which subcontracts VS-14 and VS-28 were awarded. It is therefore clear that in constructing vessels which incorporated naval defense features or which were turned over by the Commission to the Navy, the Commission was not in any sense functioning as an instrumentality of the Secretary of the Navy or the Navy Department, but was pursuing its independent functions as specifically delineated by law.

All of the construction undertaken pursuant to prime contract MCc-15762—which included the hulls upon which work was done under subcontracts VS-14 and VS-28—was strictly within the scope of the program assigned to the Maritime Commission, and quite as clearly not within the scope of the Vinson-Trammell Act.

Very truly yours,

WADE H. SKINNER,

General Counsel

Appendix B

SECTION 402 OF THE REVENUE ACT OF 1940
(ACT OF OCTOBER 8, 1940; 54 Stat. 965)

"SEC 402. SUSPENSION OF PROFIT-LIMITING PROVISIONS OF THE MERCHANT MARINE ACT, 1936, AS TO CERTAIN SUBCONTRACTS

"(a) The provisions of section 505(b) of the Merchant Marine Act of 1936, as amended, shall not apply to any subcontract which would otherwise be within such provisions if such subcontract is entered into in any taxable year of the subcontractor to which Subchapter E of Chapter 2 of the Internal Revenue Code is applicable and if the principal contractor and the subcontractor between which such subcontract is entered into are not affiliated within the meaning of subsection (b) of this section at the time such subcontract is entered into or at any time thereafter up to and including the date of its completion; and any agreement, pursuant to which the subcontractor is required to pay to the United States Maritime Commission profit in excess of 10 per centum of the contract price of any such subcontract or pursuant to which such an agreement is required to be obtained from such subcontractor relative to such subcontract, shall be without effect. This subsection shall apply only if both the principal contractor and the subcontractor are corporations.

"(b) For the purposes of this section, two or more corporations shall be deemed to be affiliated (1) if one corporation owns at least 95 per centum of the stock of

the other or others, or (2) if at least 95 per centum of the stock of two or more corporations is owned by the same interests. As used in this subsection, the term 'stock' does not include nonvoting stock which is limited and preferred as to dividends.''